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No. 375

SUPREME COURT OF THE UNITED STATES

October Term, 1965

COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

v.

PETER P. LARKIN,

Respondent.

BRIEF

Supreme Court of the United States

OCTOBER TERM, 1955.

No. 373

COMMISSIONER OF INTERNAL REVENUE,
PETITIONER,

v.

PHILIP J. LoBUE.

PETITION FOR REHEARING

Judgment in the above-entitled proceedings was entered May 28, 1956. Motion of the respondent to enlarge the time within which petition for rehearing might be filed to July 6, 1956 was granted by order dated June 15, 1956.

The respondent herewith petitions for rehearing on the following grounds.

1. *The decision is based upon misstatements of fact as to critical and pivotal points.*

a. The Opinion states "LoBue and a number of other employees were notified that they had been tentatively chosen to be recipients of nontransferable stock options *contingent upon their continued employment.*" (Emphasis

supplied—Op. p. 1).[1] The Opinion states "These three options were not transferable and LoBue's right to buy stock under them was *contingent upon his remaining an employee of the company until they were exercised.*" (Emphasis supplied. Op. p. 6).

The record provides no basis whatsoever for these statements that the taxpayer's right to exercise the options was contingent upon his remaining an employee. The only requirement for continued employment related to the first option issued January 18, 1945, and this requirement was merely that he remain employed to June 30, 1945 to comply with requirements of the Michigan Corporation and Securities Commission. (Exs. 3-C, 4-D, 5-E, 6-F, 7-G; R. 17-24; R. 143-145.) See also the Opinion of Mr. Justice Harlan. Subject to the June 30, 1945 requirement with respect to the first option, the taxpayer could have left his employment the day after receiving each option, without affecting its exercisability.

b. The Opinion states "The Tax Court held there was no taxable income, however, on the ground that *one* purpose of the employer was to confer a 'proprietary interest'." (Emphasis supplied—Op. p. 4).

The Tax Court did not state that to confer a proprietary interest was only *one* of the purposes of the options, but categorically stated that the *single* purpose of the options was the proprietary interest purpose—that they were not to any extent conferred as additional compensation (R. 146, Findings of Fact). The Tax Court stated its conception of the test it was applying as follows: "Determination of whether a stock option is granted to an employee as additional compensation, or to give him a proprietary interest in the Corporation, thus remains a question of fact. In

[1] References herein to the Opinion are made by the abbreviation "Op."

reaching that conclusion, we think the criteria set forth by this Court in *Delbert B. Geeseman*, 38 B.T.A. 258 (1938), is still the most reliable guide to be followed. In the *Geeseman* case, we said, at page 264:

> • • • *as a prerequisite to the conclusion sought by the respondent* it should definitely and clearly appear that a transaction, which in form is nothing more than a purchase and to an obvious and substantial extent is unquestionably a purchase, *is in fact to some extent* the payment of compensation for services rendered or to be rendered.

Here it 'definitely and clearly' appears that the granting of the options to petitioner in 1945, 1946, and 1947 was not intended as additional compensation for his services." (Emphasis supplied—R. 148).

This is as clear a statement as possible that there must be no purpose whatsoever to compensate, but only the single purpose to permit acquisition of stock.

The statement of the Tax Court referred to in footnote 5 of the Opinion is misleading, being itself inaccurate as to what was said in *Geeseman*, 38 B.T.A. 258. *Geeseman* does not refer to the element of "additional compensation" being present. It merely states at p. 263 that it is obvious that the elements of purchase and the employer-employee relationship are both present in every case of this type. But it is completely clear that both *Geeseman* and the Tax Court below state as the rule to be followed that the Commissioner prevails if the transaction is *to any extent* payment of compensation for services.[2]

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[2] Although impertinent to the main Opinion, the Concurring Opinion of Mr. Justice Frankfurter and Mr. Justice Clark states that the time when the taxpayer should be taxed was not in issue in either court below. On the contrary, this issue was stated as an issue and argued in the taxpayer's briefs in both courts.

2. *The decision is in direct conflict with established rules of procedure.*

This Court has defined its jurisdiction as excluding review of concurrent findings of fact by two courts below, other than in exceptional constitutional and public cases. This precedent for the guidance of litigants is precisely stated in *Graver Tank & Mfg. Co.* v. *Linde Air Prod. Co.*, 336 U.S. 271 (1948), at page 275, as follows:

> " * * * A court of law, such as this Court is, rather than a court for correction of errors in fact finding, cannot undertake to review concurrent findings of fact by two courts below in the absence of a *very obvious and exceptional showing of error.* * * * " (Emphasis supplied).

See also Rule 52(a), Federal Rules of Civil Procedure; *Great Atlantic & Pacific Tea Co.* v. *Supermarket Equipment Corp.*, 340 U.S. 147; *United States* v. *Appalachian Electric Power Co.*, 311 U.S. 377; Moore's Federal Practice par. 52.12 and cases cited therein.

The case at hand turns on a pure question of fact: were the options given as compensation for service? Without an affirmative determination Section 22(a) has no application. Both courts below concurred, on the basis of extensive stipulated, documentary and oral testimony, that the options were not given to any extent as such compensation. No *very* obvious and exceptional error (or even obvious and exceptional error) was argued or shown by the Commissioner, and the Opinion makes no reference to any obtuse fact finding below.

The Court by finding the fact, essential to its decision, that the options were given as compensation for services has departed sharply from established procedural rules and

precedent, and contrary to its own announced jurisdiction has assumed the function of a court for correction of errors in fact finding rather than one of law.

3. *The decision is contrary to all judicial precedent, including decisions of this Court.*

The Opinion is unique in not citing a single case supporting the decision on the issue involved. It states at page 3 "Disputes over the taxability of stock option transactions such as this are longstanding.", citing three cases. The disputes have not been in the courts—every court which has dealt with the issue has without exception applied the same rule that employee options result in purchase transactions if not given as compensation. The three cases cited are in strict accord with this view.

Commissioner v. *Smith*, 324 U.S. 177, cited in the Opinion merely held that *if* a stock option is given "as compensation" the employee is taxable, tacitly acknowledging that in the absence of such essential fact a purchase is made.

Palmer v. *Commissioner*, 302 U.S. 63, dealt with at length in the taxpayer's brief as supporting his position, is cited in the Opinion for the proposition that an arm's length purchase of property at a bargain price gives rise to no taxable gain. It is then distinguished from the present case on the grounds that the taxpayer here was not dealing at arm's length with his employer. The distinction between a stockholder dealing with his corporation and an employee with his employer-corporation is not defined in the Opinion, and the distinction is completely obscure. The *Palmer* case is clear that a stockholder may make a bargain purchase if it is not intended as a dividend. The opinion is clear that stockholders by virtue of their relation to their cor-

poration are not to be quarantined from the purchase and sale provisions of the Code. Unless the intention is to pay a dividend, the transaction is a purchase. The Commissioner's regulations with respect to stockholder purchases so read, but do not so read as to employees.

One and one do not make two for stockholders, and three for employees. Unless it is found as a fact that the employee is intended to be compensated by the option, he is as well-entitled to the provisions of Sections 111-113 as the stockholder. From whatever direction the issue is approached, the determination requires fact finding of intention to compensate. This is the function of the courts below, and they concurred in the finding that there was no intention to compensate.

4. *The treatment of the gift aspect is not in accord with prior decisions of the Court.*

The Opinion states "there was not the slightest indication of the kind of detached and disinterested generosity which might evidence a 'gift' in the statutory sense. These transfers of stock bore none of the earmarks of a gift." (Op. p. 3). From this premise, the Opinion then proceeds to the conclusion that the courts below properly refrained from treating the options as gifts.

This description of a gift as requiring "detached and disinterested generosity" is completely contrary to the definition established by the Court in *Helvering* v. *American Dental Co.*, 318 U.S. 322 (1943) and *Commissioner* v. *Jacobson*, 336 U.S. 28 (1949). In both these cases, purely commercial transactions involving dealings governed strictly by business motives were in issue. The rule pronounced by the Court for determining whether a gift occurred had nothing to do with "detached and disinterested generosity",

but is simply whether an effort was made to secure the best price available.

Hence, under the foregoing rule, if the employer tried to get the best price available, there was no intention to compensate and the transaction was a purchase. If the employer did not attempt to get the best price available, there was a gift if there was no intention to compensate. Unless the Court is now discarding the rule of the *American Dental Co.* and *Jacobson* cases, generosity of the employer was not a factor and the issue turns upon its intention or lack of intention to compensate. If, as the Court has previously said, this is a fact to be left with the concurrent determination of the courts below, the taxpayer should prevail.

5. If taxable, the options clearly represented gain either when granted or when notes were given therefor.

The taxpayer agrees that, at a minimum, the income, if any, was realized at the times promissory notes were given by him. But it is submitted that, particularly since the exercise was not dependent upon continued employment, the options obviously had established value and represented gain to the taxpayer at the times granted. See Opinion of Mr. Justice Harlan. Conclusion otherwise is contrary to the well-recognized doctrine of constructive receipt. Certainly a present right to purchase United States Steel stock at 50% of market has real and present value. And since the right here was independent of contigued employment, it bore no relationship to continued rendering of services. Cf. *Morse* v. *Commissioner*, 17 T.C. 1244, aff'd 202 F.2d 69 (CA-2), dealing with taxation of non-assignable annuity contracts delivered to an employee.

In conclusion, attention is directed to the Courts' finding of fact that the employer's intention was to enlist more

efficient service from the taxpayer by making him a part proprietor of the business (Op. p. 4). It is submitted that, even if the two-court finding rule is to be waived, such forward-looking intention where the taxpayer's options were not dependent upon rendering any future service bears such casual and completely unpredictable and uncertain relationship to services as not to be to any extent compensation for services under Section 22(a). The taxpayer in fact terminated his employment shortly after exercise of the options and rendered no more services to his former employer (R. 12). To say that the options were compensation for service which the taxpayer was under no obligation to render and in fact did not render, not only strains the meaning of Section 22(a) unreasonably but also points up the true purchase nature of the transactions. This case would not appear to be one for departure from the two-court finding of fact rule, and the taxpayer believes the Court should reconsider its decision.

Respectfully submitted,

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